No. 14606.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

FRANK M. CHICHESTER, Trustee in Bankruptcy for the Estate of KENNETH P. SCHMIDT BUILDERS, INC., Bankrupt,

Appellant,

vs.

CLARENCE E. POLIKOWSKY, WINNIFRED POLIKOWSKY, KENNETH P. SCHMIDT and MARY WILKINS SCHMIDT,

Appellees.

REPLY BRIEF OF APPELLEES, CLARENCE E. AND WINNIFRED POLIKOWSKY.

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Statement of the Case.

The appellant has made in his opening brief, a statement of the case. This statement goes into much detail concerning the preliminary negotiations between the parties, which were finally merged into an entirely different agreement, and although the statements are, in our opinion, substantially correct, much immaterial matter is contained. There is also an innuendo in appellants statement to the effect that appellees Polikowsky were guilty

of destroying records of the escrow company, with which innuendo we cannot agree.

With this explanation, and this exception, we adopt the Statement of the appellant so far as it goes, but make the following additions thereto:

After preliminary negotiations, the Polikowskys, appellees, agreed to transfer to the Schmidt corporation, their real property, and in consideration therefor were to receive an unsecured note executed by the Schmidt corporation, and each of the Schmidts individually. The agreement altering the previous tentative agreements between the parties, consisted of amended escrow instructions dated December 5, 1952. [Pet. Ex. 4; Tr. pp. 113-114.] These instructions were signed by each of the Schmidts, but peculiarly enough, although a place was provided on the instructions for the signature of the corporation, it was not executed on behalf of the corporation. [Tr. p. 114.]

Pursuant to the terms of those last instructions the property was conveyed to the corporation, and the appellees received their note. No payments were or have been received on account of the note. The note by its terms became due six months after December 5, 1952. In July, 1953, an involuntary petition in bankruptcy was filed against the corporation, and in October, the appellees Polikowsky brought their petition asserting their vendor's lien.

Appellant points out in his statement that:

Schmidt owned 80% and perhaps all of the stock of the corporation. [Tr. p. 93.]

He was president and director, and fully dominated the corporation. [Tr. p. 100.]

To those facts should be added:

During 1952 and 1953 all members of the Board of Directors of the corporation were there as Schmidt's sufferance; they were subject to removal by him at any time. [Tr. p. 100.]

Schmidt expended funds of the corporation on his own home, and subsequently transferred it to the corporation. [Tr. p. 100.]

The real property, subject of appellees petition, was never encumbered, nor used as an asset of the corporation, nor even set up on its books. Title was never transferred by the corporation. [Tr. pp. 135-136.]

It was not even included as an asset in the sworn bankruptcy schedules. [Tr. p. 137.]

ARGUMENT.

In reply to the Opening Brief of Appellant, we make our argument under the respective subheadings as follows:

I. Résumé of the principal proceedings had and taken in the matter of said Petition for order to show cause.

II. Appellees Polikowsky at all times since the transfer of title to the vestee corporation of the subject property, had and retained a vendor's lien thereon which was not waived:

A. By the acceptance of security other than the personal obligation of the buyers.

B. By agreeing to give a title to the effect that the public records would disclose no encumbrances.

C. By acting in such a manner as to be estopped from asserting their vendor's lien.

III. The District Court was justified in over-ruling the erroneous inferences drawn by the Referee from the undisputed and uncontroverted facts.

IV. The finding of the District Court that the bankrupt was but the *alter ego* of Schmidt and his wife, and should not be treated as a separate entity was the only inference which should be drawn from the facts.

V. The question of the Jurisdiction of the Bankruptcy to enforce the vendor's lien of appellees Polikowsky.

VI. Miscellaneous.

A. Appellants were not guilty of destroying records of the escrow company.

I.

Résumé of Principal Proceedings.

This case was initiated by the filing in the United States District Court, in the matter of Kenneth P. Schmidt Builders, Inc., alleged bankrupt, of the said petition praying for an order to show cause to be issued directed to said Keneth P. Schmidt, Mary Wilkins Schmidt, Kenneth P. Schmidt Builders, Inc., and Frank C. Chichester, Trustee in Bankruptcy for said corporation, ordering them to show cause, if any they had, why the vendor's lien described in the petition should not be impressed upon the real property likewise described, or why the court should not declare that said persons and corporation had no interest in said real property, or why petitioners should not be permitted to bring suit in the courts of the State of California to impress their vendor's lien.

Answers were made thereto by said Frank Chichester, as Trustee, by the corporation, and Kenneth P. Schmidt and Mary Wilkins Schmidt, individually, and thereby issues were joined.

The case was tried before Honorable Reuben G. Hunt, Referee in Bankruptcy, the Transcript of the hearing commencing on page 79 of the Transcript of the Record. An index of the Transcript appearing on pages I, II and III of the Transcript indicates the location of the record of the proceedings, trial procedure, and all other pertinent matters contained in the Transcript.

Thereupon the said Referee in Bankruptcy filed herein Findings of Fact, Conclusions of Law, and Order on Petition in Reclamation of Clarence E. and Winnifred Polikowsky, thus designating and referring to the said petition on order to show cause hereinbefore mentioned.

By this order [Tr. p. 44] the Referee ordered that the petition of the appellees Polikowsky be disallowed, and determined that the property in said petition described was the property of the bankrupt corporation, free and clear of any claim of the petitioners.

Thereupon the said petitioners filed in said District Court their Petition for Review of Order of Referee.

The Petition (Amended) came on for hearing before Honorable Harry C. Westover, Judge of said Court, and basing his findings and decision upon the same uncontroverted and undisputed evidence as was before the Referee, the court made and filed its Findings of Fact, Conclusions of Law, and Order on said Petition on review, and Judgment thereon.

By this judgment, the said judge of said District Court held in effect [Tr. pp. 63-74] that Schmidt and his wife were the purchasers; that the corporation was not to be regarded as a separate entity under the circumstances of this case, and that the bankrupt corporation had no interest in the real property. He further held that the bankruptcy had no jurisdiction to impress a Vendor's Lien upon the property of Schmidt and his wife who were not bankrupt.

From this judgment of the Judge of the District Court, this appeal has been taken.

II.

Appellees Polikowsky at All Times Since the Transfer of the Subject Property to the Vestee Corporation Had and Retained a Vendor's Lien.

The theory that a vendor who had not received the purchase price of his real property was entitled to a lien thereon, was at an early date adopted by the equity courts without the necessity of legislative sanction, the equitable principle involved being deemed sufficient.

The legislature of the State of California saw fit to make this principle a part of our written law, in 1872, and the Section, so far as we can determine, has undergone no change since that time. The Civil Code, Section 3046, though simple, is extremely comprehensive, and reads as follows:

> "One who sells real property has a vendor's lien thereon independent of possession, for so much of the price as remains unpaid and unsecured otherwise than by the personal obligation of the buyer."

The courts of the State of California, and the Supreme Court of the United States have commented upon the nature and effect of the vendor's lien with approval, calling attention to the equitable principle upon which it is based:

> "The rule of our Civil Code was intended to make more clear and definite the equity rule as to vendor's liens. The principle upon which this lien has been established by courts of equity is that a person who has gotten the estate of another ought not, in conscience as between them, to be allowed to keep it and not pay the full consideration money. The true origin of the doctrine may with high probability be ascribed to the Roman Law from which it was im-

ported into the equity jurisprudence . . . 'There can be no doubt that the existence of such a lien is among the settled doctrines of the English chancery . . . Its foundation exists in the general principles of equity and moral justice, by which the seller is entitled to hold upon the estate until he gets the price.' The lien of the vendor is of so high a nature that it is not extinguished by his death, but passes to his representatives. Nor is it discharged by death of the grantee, but may be endorsed against his estate, or those into whose hands the property may come."

Selna v. Selna, 125 Cal. 357.

"It is a doctrine of equitable jurisprudence which says that land, which is immovable, is the best security for its own price, and that title thereto should therefore pass subject to the equitable burden of such security."

Seymour v. Slide and Spur Mines, 153 U. S. 509, 38 L. Ed. 802.

A. Appellees Polikowsky Did Not Waive Their Vendor's Lien by the Acceptance of Security Other Than the Personal Obligation of the Buyers.

While the rule is different in some states, it is clearly the law in California that the acceptance of security other than the unsecured obligation of the purchasers is a waiver of the vendor's lien. Hence, the acceptance of the guarantee of a third person is deemed to waive the lien.

The facts in the instant case are that the only consideration given for the vendor's real property, was a promissory note signed by Schmidt, his wife, and the Schmidt corporation. Those same signatures are to be found on the agreement of exchange, by the terms of

which the property was agreed to be placed in the name of the Schmidt corporation.

The only contention which could be made that vendor received any security other than the personal obligation of the purchasers would be upon the basis that Schmidt, his wife, or the corporation, all signatory thereto, were third party accommodation makers or guarantors.

The District Court held that this corporation was not to be regarded as a separate entity in this transaction, which finding was amply justified, as we shall later argue.

The signature of Schmidt's wife on the promissory note was not that of an accommodation maker but was the signature of one of the purchasers. Not only was she a party signatory to the escrow agreement, but her community interest in the acquisition was such that her signature is not considered that of a third party accommodation maker.

Property acquired by either party to the marriage, during the marriage relationship is presumptively community property.

Wilson v. Wilson, 76 Cal. App. 2d 119;
Wood v. Gunther, 89 Cal. App. 2d 718.

Where a wife co-signed a note with her husband, which was given in consideration for the transfer of real property to him, the Supreme Court of Idaho held as follows:

> "If, however, as suggested on the other hand, this property became community property between the husband and wife, then the wife's signature to the note would not constitute security within the contemplation of the statute, but would merely be evidence of the community indebtedness or the signature of

one of the purchasers, in which event it would not constitute security within the purview of the statute."

Smith v. Schultz, 23 Idaho 144, 129 Pac. 640.

We think it logical and equitable that where a wife has an equal share in the community property of the marriage, she should not be heard to contend that her signature on the promissory note given in the acquisition of such property is that of a third party guarantor, and not that of an interested party.

B. Appellees Polikowsky Did Not Waive Their Vendor's Lien by Agreeing to Give a Title in Such Manner That the Public Records Would Disclose No Lien nor Incumbrance.

Appellants argue with great force, that the case of *Edison Securities v. Ventura Guarantee Building and Loan Association,* 10 Cal. App. 2d 555, holds that where a vendor agrees to provide instruments entitling the escrow holder to procure a Standard Owners policy of title insurance showing title vested in a vestee free of encumbrances, such agreement waives the lien.

We feel that there are several cogent reasons why this case is not controlling under the facts of the case presently before the court.

In the first place, the provisions of the Standard Owner's title insurance were not before that court, and the exceptions set forth in such policy of title insurance were not a part of the record. The policy of title insurance which was procured pursuant to the agreement of the petitioners, appellees herein, is before this Court. [Pet. Ex. 6, pp. 167 to 179.] This policy of title insurance specifically excepts all liens and encumbrances not shown

on the public records. A vendor's lien is, by its very essence, not a matter of public record, for if it were, it would lose its character as an implied lien, but would then become an express lien. If the courts were to read into the law, a waiver of the vendor's lien arising from an agreement to convey a title showing no record of encumbrance, such would be judicial legislation, and in clear derogation of the statute.

The *Edison Securities* case *(supra)* is interesting for another reason. The decision in that case holds that inasmuch as the vendor received investment certificates of the vendee, most of which were paid when due, the acceptance of the investment certificates was the acceptance of a security, within the meaning of the statute. The learned judge gives, as an additional and we believe unnecessary reason, that an agreement to furnish a title free of encumbrances waives the vendor's lien, *as the lien was an encumbrance.* Both before and after the ruling in the *Edison Securities* case, *supra,* the law in California has been as follows:

> "A vendor's lien is not an absolute charge upon the land but a mere personal privilege to resort to if desired as a means of enforcing the contract."
>
> *Schwartz v. Mead,* 116 Cal. App. 606;
>
> 17 Cal. Jur. 718.

The learned Justice who wrote the opinion in *Edison Securities* case *(supra)* was Jamieson, Justice *Pro Tem.* His opinion was concurred in by Pullen, Presiding Judge, and Justice Thompson. Three years later, in an opinion delivered by Justice Thompson, and concurred in only by Pullen, P. M. (there being no dissent) the same division

of the District Court of Appeal quoted with approval the following language:

> "A vendor's implied lien after conveyance is created by the law and not by contract of the parties as are mortgages. It is not a specific absolute charge on the land, but a mere equitable right to resort to it upon failure of payment by the vendee, that is, it is in its nature a personal privilege, unassignable, which the vendor can assert only in a suit brought for the purpose of having it decreed and forced."
>
> *In re Reid's Estate,* 26 Cal. App. 2d 362.

We gather from the foregoing language, that the nature of a vendor's lien is such that it is not truly a lien nor encumbrance at the time of conveyance, and cannot be asserted until the vendee has defaulted in his obligation. If our interpretation be correct, a vendor's lien is not an incumbrance upon real property within the meaning of Section 1114, Civil Code, until default in vendee's obligation to pay the purchase price.

Appellant also cites the case of *Royal Consol. Min. Co. v. Royal Consolidated Mines Co.,* 157 Cal. 737, as authority for the proposition that a covenant to give clear title excludes the intention to retain a vendor's lien. This case, by reason of its facts is not in point in that the substantial rights of third persons were so affected as to estop vendor from asserting his lien. In the words of the court:

> "In other words, the agreement contemplated that a title apparently free and unencumbered, should be conveyed to a corporation which should, upon the basis of such title, issue and sell its shares in an amount exceeding a million dollars."

The court continued, distinguishing its holding from an earlier case decided by the United States Supreme Court in the following language:

> "It is true that in Slide and Spur Gold Mines v. Seymour, 153 U. S. 509, 38 L. Ed. 802, it was held that a somewhat similar covenant was to be construed as referring 'to prior charges and incombrances' and not to 'any which arise out of the conveyance itself.' But in that case there was but a single transfer directly from the vendor to a corporation organized by the vendee to take title. Here the property was to be conveyed to Van Ee, and by him to a corporation. Even if we give to the covenant for a transfer free and clear of encumbrances the restricted meaning applied in the Slide and Spur case, the vendor's lien claimed must have attached at the moment of the transfer to Van Ee. It would, therefore, have been prior to the conveyance by Van Ee to the British corporation, and was excluded by the provision that that transfer should be free of incumbrances."

We feel that the particular question in this case as to whether a vendor's agreement to give a title free or clear of incumbrances, or to convey such a title that the public records will not disclose incumbrances (the latter being the situation in the case before this court) is completely answered by the Supreme Court of the United States in the following language:

> "An intent to abandon it (referring to a vendor's lien) is not to be presumed, and while of course, like any other right it may be abandoned or waived, the evidence of an intent so to abandon or waive should be clear and satisfactory.
>
> "It is not questioned in this case that a large part of the money consideration for the sale of these mines

> still remains unpaid, and the defendant is in the attitude of one who, admitting that the vendors have not received the money for which they sold the land, nevertheless insists upon retaining the property discharged of any obligation for its payments . . . But the provision that the property should be free from all charges and encumbrances obviously refers to prior charges and encumbrances, and does not exclude any which arise out of the conveyance itself. It means simply that the grantors shall have removed all burdens which rested upon the property prior to the time of making their deed and that the deed shall pass the title perfect and unencumbered, but not that the grantee shall take it free from all obligations of payment or discharged from the lien for the purchase price which rests upon real estate until such price is paid."
>
> *Seymour v. Slide and Spur,* 153 U. S. 509, 38 L. Ed. 802.

The only inequity which would result from the assertion of the vendor's lien in the present case would be the disappointment on the part of the Schmidts occasioned by their failure to acquire the property of appellees without payment. The disappointment caused by this blow to their expectations is not such as to cause any court serious concern.

The comments of the Supreme Court of the State of California in the case of *Finnell v. Finnell,* 156 Cal. 589, indicates clearly the California rule in connection with appellant's contention:

> "Unless plaintiff waived his rights in that behalf, he acquired at the time of this sale to his father a vendor's lien on the property so conveyed by him, for so much of the price as remained unpaid and

unsecured otherwise than by the personal obligation of the buyer, which lien was valid against everyone claiming under the buyer except a purchaser or incumbrancer in good faith and for value. Civil Code 3046 and 3048. Whatever may be said against the policy of allowing such a secret lien, not evidenced by any writing or public record, our Legislature has seen fit to look with favor upon it, and to continue in force the old equity rules in regard thereto . . . Our law, recognizing this as a just principle, gives to every vendor, in the vendor's lien declared by Section 3046, security for, and a means of enforcing payment of the consideration, so far as it can do so without injury to the rights of bona fide purchaser or incumbrancers for value . . . But the lien is presumed to exist, and is an incident of the transaction of sale, in all cases unless the intention of the Vendor that it shall not exist be clearly manifested by his acts or declaration, and the burden of proof is on the Vendees or his successors to show such intention . . .

"It is claimed that the evidence shows that the plaintiff knew that his father intended to mortgage the land to James H. Goodman & Co. Bank in order to take up plaintiff's notes to him . . . Plaintiff had no actual knowledge of his father's intention to mortgage this land, but it is claimed that the knowledge of his agents was imputed to him . . . We do not consider this claim well based under the circumstances . . . The matter of obtaining the necessary funds wherewith to make the purchase from plaintiff was a transaction solely between the purchaser and the bank, with which plaintiff had nothing whatever to do . . ."

C. Appellees Polikowsky Are Not Estopped From Asserting Their Vendor's Lien by Reason of Having Done or Said Something Inconsistent With the Assertion of Their Lien.

The vendor's lien is a creature of equity, and it is most appropriate that the equitable doctrine of estoppel be imposed, where necessary to prevent the improper assertion of a vendor's lien.

It is urged that the conveyance by the vendor with knowledge that the vendee intended to mortgage the property for the purpose of procuring funds with which to pay the vendor would be such an act. Appellants make the distinction between an intention to mortgage the property for the *purpose of obtaining funds for purchase thereof*, and for other purposes, for the reason that the California courts have already held that a vendor could follow the equity remaining, over and above the amount of the mortgage, and assert his lien thereof even though he conveyed for the purpose of enabling vendee to encumber. (See *Maltby v. Conklin,* 50 Cal. App. 201.) So they endeavor to draw the finer distinction which is not specifically covered in our cases, that a difference occurs where the purpose of the mortgage is shown to have been for the purpose of paying the purchase price.

Now in the first place, there was no testimony that the purpose of the incumbrance was to obtain funds with which to pay the vendee. Counsel made an offer of proof concerning testimony to that effect. The Referee at first denied the offer of proof, but subsequently reopened the case to permit the testimony to be given. But even after reopening the case for that purpose, the testimony did not indicate that such was the purpose of the contemplated incumbrances. Nor was it logical that it would have been.

The note was due within six months after the signing of escrow instruction. [Tr. p. 20.] The property had to be made ready for subdivision, with engineering, and approval of the Real Estate Commission. Streets and utilities were required to be provided. [R. p. 85.] It is not probable that the purchasers conceived that all of this could be done, and homes erected and sold within six months. MacArthur testified that the funds were to come from a subdivision which Schmidt was completing in Monterey Park. [R. p. 157.] Schmidt merely testified that he had arranged for loans to build houses. [R. p. 135.] Nevertheless, the appellants insist that the purpose of the contemplated encumbrance was to pay vendor.

Assuming arguendo, that such was the purpose, the situation does not change. No encumbrance was ever put on the property and no rights of innocent third parties have intervened. The California rule which has been announced in connection with this doctrine of estoppel is as follows:

> "The true doctrine as outlined by these authorities in this state, and as fully sustained by the great weight of authority in other states, would seem to be, that in order to constitute a waiver of a vendor's lien there must be some act or omission on the part of the vendor inconsistent with his assertion of the lien, and evincing his intention to waive it, and that it must be such an act or omission as would render it *inequitable to thereafter assert it.*" (Emphasis added.)
>
> *Brown v. Kahn,* 176 Cal. 159.

III.

The District Court Was Justified in Overruling the Erroneous Inferences Drawn by the Referee From the Uncontroverted and Undisputed Facts.

At the outset we should mention that the facts of this case are not in dispute. The Referee so stated, in the following language. "The facts do not appear to be in dispute." [Tr. p. 23.] The District Court so held. [Tr. p. 72.] Appellants have not set forth any controverted testimony. Our recollection of the proceedings, and our careful reading of the Transcript discloses no dispute as to any of the facts.

This Honorable Court has previously held, in a circumstance in which there is no dispute as to the facts, but only questions of law are presented, that the inferences drawn by the Referee are in no manner binding upon review.

> *Weisstein Bros. and Survol v. Laugharn,* 84 F. 2d 419.

The most recent expressions of this same rule which we have been able to find are as follows:

> "This Court is inclined to agree with the Trustee and the Bank that there are no substantial issues of fact presented to it for determination. That being the case, the only questions presented here are those of law. In such a situation, it is a familiar doctrine that a reviewing court must exercise its independent judgment. The presumption of correctness of the Referee's finding is not extended by General order XLVII see 11 USCA following section 53, to his conclusions of law."
>
> *In re Hedgeside Distillery Corp.,* 123 Fed. Supp. 933 (942).

In speaking of a Referee in Bankruptcy,

> "When his conclusions are based upon an inference from undisputed facts or upon an interpretation of an instrument, it is not binding on review."
>
> *In re Kelly,* 85 Fed. Supp. 316.

If we understand appellants position clearly, it is his contention that several of the findings of the District Judge are not supported by the evidence, but that the findings of the Referee are supported. We do not feel it desirable to belabor the issues by first pointing out the erroneous conclusions of the Referee and then supporting the findings of the District Court by excerpts from the testimony. But we will nevertheless endeavor not to dodge issues raised by appellant.

Appellant argues at some length that as Mary Wilkins Schmidt was not signatory to the first escrow instruction of October 30, 1952, the escrow was not *opened* by her. As the finding is not particularly material, the escrow instructions of that date having been completely amended, we feel extended discussion is unnecessary, but would only point out that by signing the amendment, she adopted the unchanged portions of the original instructions.

Appellant point out that the finding of the District Court as to the parties to the amended instructions was incorrect in that he did not find the corporation a party to the amendment of December 5, 1952. The escrow instructions of December 5, 1952, were signed by the Schmidts and not by the corporation. The District Court had as good an opportunity to examine the instructions [Pltf. Ex. 4] as did the Referee. Where an instrument concerning the covenance to real property is not signed by a party, it seems obviously correct to conclude that the parties *signatory only* were bound, thereby.

IV.

The Findings of the District Court That the Bankrupt Schmidt Corporation Was but the Alter Ego of Schmidt and His Wife, and Should Not Be Treated as a Separate Entity, Was the Only Inference Which Should Be Drawn From the Facts.

The doctrine of piercing the corporate veil is one which has received the careful consideration of our court on many occasions. We propose to treat this subject by first pointing out what we understand to be the accepted requirements, by next pointing wherein the instant case falls within all such requirements, and lastly by quoting from numerous California cases illustrative of the rule.

A. The Requirements Which Must Be Present Before the Corporate Veil May Be Pierced Are as Follows.

1. The capital stock of the corporate *alter ego* must have a unity of ownership and the owners thereof act in unity or in concert in relation to the corporation and its affairs.

2. There must be such a unity of interest and ownership between the corporation and its owners that the individuality of such corporation and such persons has ceased.

3. If the separate identity of the corporation is maintained distinct from that of the stockholders an injustice or inequitable result will be done some third party. It is not necessary that actual fraud be shown, but it is sufficient that an inequitable result would follow.

B. The Schmidt Corporation Was but the Alter Ego of Its Owners, the Schmidts.

The Schmidt corporation was owned and dominated by Schmidt. Even the Referee so found. [Tr. pp. 83-84.] At all times herein mentioned the directors of the corporation were appointed by Schmidt and at all times held their membership at his sufferance and subject to his dismissal. Schmidt commingled his funds and his real property with those of the corporation. He represented to the appellees Polikowsky that he and the corporation were one and the same. [Finding VIII, Tr. pp. 67, 164-165.]

Schmidt's attitude toward the corporation is illustrated by his testimony, which we will quote, and by two peculiar circumstances which make it evident that he considered the corporation but a conduit through which he did business.

Comment has been made before that the corporation did not sign the effective escrow instructions by virtue of which appellees transferred the property. This fact seems to us a clear indication that the corporation was considered as a mere formality, but had no true existence as such, and on this occasion it did not seem to serve any particular purpose even to observe the form.

A second, and as revealing an indication is found in the fact that Mary Schmidt signed the promissory note in favor of the appellees, as *Secretary* of the corporation, as well as individually.

Schmidt testified and reiterated and it was not contradicted, in referring to his wife: "She was never secretary." [Tr. pp. 94-95.]

The signing of the promissory note as *secretary* of the corporation, although she was never the secretary, only

serves to further illustrate the point that the Schmidts did not consider nor look upon the corporation as a separate entity, but as a mere fiction, and in this case, even the pretense of proper formality was dispensed with.

Schmidt's testimony before the Referee is equally illustrative of his attitude that the corporate entity was merely a method of his doing business. Excerpts from his testimony are as follows:

> "*I* would like to take title in the corporation." [R. p. 81.]
>
> "*We* wanted to build these particular houses in that corporation." [R. p. 81.]
>
> "The business was all in the corporation. That was the only building project *I* had going and the only corporation." [R. p. 101.]
>
> "*My* records (referring to the corporation records) were never up to date." [R. p. 101.]
>
> "*I* would like to have title delivered to Kenneth P. Schmidt Builders, Inc. . . . It would be better for *us* to develop their property under the building company . . . and for the purpose of borrowing money. . . ." [R. p. 133.]
>
> "I told them that the Mutual Savings and Loan where we had the escrow opened had given *me* a a verbal commitment to finance the homes and *I* would borrow. . . ." [R. p. 135.]
>
> "All I did was spend several thousand dollars engineering the map." [R. p. 136.]

There is little doubt after reading the testimony of Schmidt himself that he considered that he was doing business under the corporate name, and that in his own mind the corporate entity was merely a fiction.

In Schmidt's own words the Polikowskys felt that they were doing business with him through his dummy corporation. "Well I think they actually believed they were doing business with myself as an individual." [Tr. p. 82.]

Neither the Referee nor the appellants were able to see any particular inequity in the loss by appellees of their real property without payment therefor. They impliedly admit that many of the requirements toward piercing the corporate veil are here present, but insist that there is no fraud, injustice nor inequity here present which necessitates that the separateness of the corporation and its owners be ignored. It seems to us self-evident that where the recognition of a dummy corporation would deprive another of his property without payment therefor, an inequity or unjust result would obtain. And if it merely be necessary to ignore the separateness of the dummy corporation in order to prevent a palpable injustice, the courts have never hesitated to brush aside the corporate veil.

C. The Cases in California Concerning Piercing the Corporate Veil Are Quite Voluminous, and We Feel an Obligation to the Court to Give Excerpts of the Cases Which We Consider Illustrative of the Rules.

> "The fusion of corporate entity with that of the principal stockholder *need not be forged out of the existence of actual fraud;* it is sufficient if inequitable results to third persons will flow from a nonrecognition of the identity of corporate and individual existence." (Emphasis added.)
>
> 12 Cal. Jur. 2d 606.

"Separate entity will be disregarded, *though actual fraud need not be shown,* and it is sufficient if a refusal to recognize the *alter ego* relationship will bring about inequitable results." (Emphasis added.)

Gordon v. Aztec Brewing Co., 33 Cal. 2d 514.

In the case of *Wenban Estate, Inc. v. Hewlett* (1924), 193 Cal. 675, the rule which the claimants in the present matter would urge is stated in the following language:

"When necessary to redress fraud, protect the rights of third persons, or to prevent a palpable injustice, the law and equity will intervene and cast aside the legal fiction of independent corporate existence, as distinguished from those who hold and own the corporate capital stock, and deal with the corporation and stockholders as identical entities with identical duties and obligations.

"That the identity of Caroline S. Wenban and the corporation are the same cannot, under the practically admitted facts of the case, be doubted or disputed. She was at all times following the formation of the corporation the sole owner of all of the shares of the stock of the corporation. Caroline S. Wenban at all times controlled and directed the affairs of the corporation as if she and the corporation were one. She herself testified in effect that all of the corporate stock of the corporation belonged to her and that she practically controlled the corporation in all of its action and that the directors of the corporation, who were members of her family, did whatever she wanted them to do with regard to the corporation, and this testimony stands undisputed. The corporation was organized for the sole purpose of owning and operating Caroline S. Wenban's property. It was created merely as a convenience for the management of her property. There was a complete

unity of interest and ownership in the assets of the corporation between Caroline S. Wenban and the corporation. In other words, the corporation was her *alter ego*. That the corporation was looked upon as the *alter ego* of Caroline S. Wenban is evidenced by the acquiescence of the other directors of the corporation in her conduct whereby she treated the bonds of the corporation as her own. In such a situation her responsibility as the sole shareholder of the corporation, when dealing with the assets of the corporation, was the corporation's responsibility, and conversely the obligation of the corporation in this particular situation is her obligation."

Further to bring into relief the situation we are considering, we quote again from the case:

"Accordingly, it has been held that upon a sufficient showing a corporation is but the instrumentality through which an individual, who is the sole owner of all of the corporate capital stock, for convenience transacts his business, equity, looking to the substance rather than the form of the relation, and the law as well, will hold such corporation obligated for the acts of the sole owner of the corporation to the same extent and just as he would be bound in the absence of the existence of the corporation. (*Llewellyn Iron Works v. Abbott Kinney Co.,* 172 Cal. 210 (155 Pac. 986); *Commercial Security Co. v. Modesto Drug Co.,* 43 Cal. App. 162 (184 Pac. 964); Minifie Rowley, 187 Cal. 481 (202 Pac. 673).) Thus proof that an individual owns all of the stock of a corporation and that the corporation is in truth and in fact but the corporate double of the owner of the stock, will, in conjunction with a further showing that as a result of the double relationship fraud or injustice will inure to a third person, suffice to dissipate the separate identity of the corporation. (*Mini-*

fie v. Rowley, supra.) In such a situation, where, as here the rights of third persons are involved, the law will have no compunction in holding the contract of the owner of the corporation dealing with the corporate assets, to be the contract of the corporation. *Porter v. Lassen County Land Co.,* 127 Cal. 261 (59 Pac. 563); *Schuyler v. Pantages,* 54 Cal. App. 83 (201 Pac. 137); *Swartz v. Burr,* 43 Cal. App. 442 (185 Pac. 411).

"It is at once apparent, in the instant case, that an adherence to the fiction of independent corporate existence would permit Caroline S. Wenban, despite the fact that she herself ignored the corporate fiction and treated the bonds in suit as her own, to seek shelter behind a corporate existence, which was no more nor less than her individual self, and thereby escape all liability for obligations to third persons incurred by her in her dealings with the assets of the corporation. In short, an adherence to the fiction of independent corporate existence, under the circumstances of the instant case, would permit Caroline S. Wenban to secure an advantage over third persons, through the medium of the corporation, to which she would not be entitled as an individual and which it would be inequitable to permit her to obtain and retain.

"True there is no showing or claim of fraud in the instant case on the part of Caroline S. Wenban or the corporation plaintiff. Still, as previously indicated, it is not necessary that actual fraud be shown. It is sufficient if a refusal to recognize the fact of the identity of the corporate existence with that of the individual would bring about inequitable results. All of the facts and circumstances surrounding the inception of and attending the controversy in suit bring the case clearly within the two require-

ments declared in *Minifie v. Rowley, supra,* to be sufficient to constitute the cause of action stated in the cross-complaints of the several appellants."

The case of *Clark v. Millsap* (1926), 197 Cal. 765 is another example of the rule where the corporate entity may be disregarded in order to promote justice.

"It is a well recognized rule of law that a corporation may be considered a legal entity when used for the accomplishment of a legal purpose. Corporations, however, cannot be used as a cover under which wrongs may be committed and fraud perpetrated. In such a case the court will look through the form of the corporation to ascertain its actual purpose and intent. If the purpose and intent of the corporation are bad, its corporate entity will be no cover for wrong, fraud, and bad faith. (*MacFadden v. Jenkins,* 40 N. D. 422 (169 N. W. 151).) Upon the dissolution of a corporation the directors become the trustees for the creditors and they may be sued in any court in the state. (Sec. 400, Civ. Code.) This does not mean, however, that a person who has at all times exercised absolute control over a corporation and used it wrongfully as a medium to enrich himself will not be held personally responsible for this misfeasance. And it may not be necessary under some circumstances to make the corporation which was used as an entity merely to consummate a wrong, a party to the action. The facts of a case may be such as to require a court of equity, which always has inherent power in such cases, to treat the corporation and the individuals owning all of its stock as identical. Thus corporate entity, existing as such entirely distinct from its members, may be ignored in order to circumvent the fraudulent purposes of the stockholders in its organization. (*Ayer*

& Lord Tie Co. v. Commonwealth, 208 Ky. 606 (271 S. W. 693).) In order to redress wrongs committed by fraud and protect third persons' rights or to prevent a palpable injustice, equity will interfere and cast aside the legal fiction of a corporate existence and deal with the corporation and stockholders as identical entities with identical duties and obligations. 'Where an individual is the owner of all the corporate capital stock and uses the corporation merely as an instrumentality through which he transacts business the separate entities will be disregarded when necessary to prevent fraud and to protect the rights of third persons.' (*Minifie v. Rowley,* 187 Cal. 481, 487 (202 Pac. 673); *Wenban Estate, Inc. v. Hewlett,* 193 Cal. 675, 696 (227 Pac. 723, 731).) In the last cited case this court said that when such a situation exists, 'equity, looking to the substance rather than the form of the relation, and the law as well, will hold such corporation obligated for the acts of the sole owner of the corporation to the same extent and just as he would be bound in the absence of the existence of the corporation.' While many of the cases cited relate to a situation where but one individual uses the corporate name in the manner suggested, the principle is the same when two or more own the stock and act in conjunction in the name of the corporation. (*McCormick-Saeltzer Co. v. Grizzly Creek Lumber Co.* (Cal. App.) 240 Pac. 32); *Zenos v. Britten-Cook Land & Livestock Co., et al.,* (Cal. App.), (242 Pac. 914); 6 Cal. Jur. 591.) 'Corporate entity is ignored in order that fraud or some kindred wrong may de defeated.' (*Erkenbrecher v. Grant,* 187 Cal. 7 (200 Pac. 641); *Relley v. Campbell,* 134 Cal. 175 (66 Pac. 220); *Rutz v. Obear,* 15 Cal. App. 435 (115 Pac. 67); *Deming v. Maas,* 18 Cal. App. 330 (123 Pac. 204); *Minifie v. Rowley, supra.*) The

> doctrine of corporate entity is not so sacred that a court of equity will hesitate to look through form to the substance of the thing and it may in proper cases ignore it to preserve the rights of persons imposed upon or circumvented by fraud. In such cases corporate fiction is disregarded."

The case of *D. N. & E. Walter & Co. v. Zuckerman* (1931), 214 Cal. 418, is a typical case for the application of the doctrine of corporate *alter ego*. For many years one Joe Goldberg was engaged in business under the fictitious name of Home Builders Supply Co. The defendant, Zuckerman, had guaranteed to plaintiff that said Joe Goldberg, doing business under said name, would pay for goods supplied him. Thereafter Goldberg organized a corporation under the name of Home Builders Supply Company. All of the capital stock, except qualifying shares, was issued to Goldberg, and he continued at all times to hold all of the capital stock. The merchandise, on account of which the balance of the purchase price is now sued for, was furnished after the incorporation of the corporation. Before the incorporation payment checks were issued to the plaintiff and signed "Home Builders Supply Co. by Joe Goldberg." After the incorporation the checks were signed "Home Builders Supply Co., a corporation, by Joe Goldberg, President." Goldberg became involved financially, and the plaintiff sued Zuckerman as guarantor of the account. Findings and judgment went for the defendant on the theory that the incorporation and Goldberg's transaction of business under the name of the corporation so changed the relationship of Zucker-

man as to release him as guarantor. This judgment was reversed, the Supreme Court holding in that behalf as follows:

> "We think the trial court was in error in its conclusion on the undisputed facts. The corporation was distinctly a one-man corporation. It was Goldberg's *alter ego,* completely owned, dominated and controlled by him. This was also true as to the business formerly conducted by him under the same name. To all intents and purposes Goldberg at all times involved herein contained to transact business under the name of 'Home Builders Supply Co.' The separateness of the person and the corporation would of course be recognized if no equitable results would follow. But where, as here, an inequitable result would follow the two should be considered as one, and the doctrine of *Minifie v. Rowley,* 187 Cal. 481 (202 Pac. 673) and *Wenban Estates, Inc. v. Hewlett,* 193 Cal. 675 (227 Pac. 723), would apply."

In the case of *Groether v. Meyer Rosenberg, Inc.* (1936), 11 Cal. App. 2d 268, 271, the court disposes of the corporate identity in the following words:

> "If the foregoing allegations are true, then Meyer Rosenberg, Inc., is doubtless liable for the debts of Meyer Rosenberg individually, for it is well settled that inasmuch as the separate personality or capacity of a corporation is but a statutory privilege, it must not be utilized for fraudulent purposes, such as a cloak or disguise for the evasion of contracts or other obligations; and that where it appears that it is being used merely as an instrumentality through which an individual who is the owner of its capital stock transacts his business, both law and equity will hold the corporation liable for the obli-

gations of its owner. (6 Cal. Jur. 597, 598; 6a Cal. Jur. 75; *Stanford Hotel Co. v. M. Schwind Co.,* 180 Cal. 348 (181 Pac. 780); *Meizlisch v. San Francisco Wool Co.,* 213 Cal. 668 (3 Pac. 2d 310).)"

In the case of *Mirabito v. San Francisco Dairy Co.* (1935), 8 Cal. App. 2d 54, at page 59 it is said:

"Separate corporate identity, however, is not always available as a defense. Where there is such a unity of interest and ownership that the separateness of the corporations has ceased and the facts are such that an adherence to the fiction of a separate existence of the corporation would under the particular circumstances sanction a fraud or promote an injustice, separate identity will be disregarded. (*Minifie v. Rowley,* 187 Cal. 481, 487 (202 Pac. 673).) Thus it has been held that where a corporation was but the instrumentality through which an individual for convenience transacted his business, all of the authorities, not only equity but the law itself, would hold such a corporation bound as the owner of the corporation might be bound, or conversely, hold the owner bound by acts which bound his corporation. (*Llewellyn Iron Works v. Abbott Kinney Co.,* 172 Cal. 210, 214 (155 Pac. 986); *Industrial Research Corp. v. General Motors Corp.,* 29 Fed. 2d 623, 625.)"

The law of this State is that the separate corporate entity will not be honored where to do so would be to defeat the rights and equities of third persons.

Kohn v. Kohn, 95 Cal. App. 2d 708, 214 P. 2d 71.

"The issue is not so much where, for all purposes, the corporation is the *"alter-ego"* of its stockholders or officers nor whether the very purpose of the organization of the corporation was to defraud the individual who is now in court complaining, as it is an issue of whether in the particular case presented and for the purposes of such case justice and equity can best be accomplished and fraud and unfairness defeated by a disregard of the distinct entity of the corporate form."

Taylor v. Newton, 117 A. C. A. 938, 257 Pac. 2d 68.

IV.

Jurisdiction of the Bankruptcy Court to Determine All Questions of Vendor's Liens in This Matter.

Our learned opponents who have appeared many times before this honorable Court, are considered as experts in the field of bankruptcy. We do not pretend to be familiar in all of the niceties of bankruptcy practice, and in connection with the ruling of the District Court that he had no jurisdiction over the Schmidts personally in this case, we can only comment that our research led us to believe that he did have jurisdiction to make a final decision concerning the vendor's lien. This we felt to be particularly true, inasmuch as the Schmidts saw fit to have the property placed in the name of their dummy corporation, the bankrupt herein, and inasmuch as they personally appeared and vigorously contested appellees petition.

For these reasons we make no argument in opposition to appellants' contention.

V.

Miscellaneous.

(a) Appellant in his statement of the case, in referring to some escrow instructions dictated by MacArthur, the broker, makes the following comment: "These instructions were not produced by Appellees, perhaps because they may have been destroyed long before this litigation for reasons which will hereafter become apparent." (Appellants Br. p. 6.)

If appellant infers by this statement that the appellees, Polikowsky, were guilty of destroying records of the Mutual Savings and Loan Association, the escrow holder, we wish it to be understood that such actions appear most unlikely, and we have no knowledge thereof. Nor can we see any point in their having done so, as the reasons have not thereafter become apparent.

(b) The Referee made quite a point out of his admission of evidence concerning the preliminary negotiations, and appellant has commented that no complaint on this point has been made. We feel that there is no need for comment. There was no attempt on the part of the appellees to avoid any of their actions in this case, nor any subterfuge. The fact that the original negotiations contemplated the placing of incumbrances on the property in favor of the vendor's does not alter the fact that no incumbrance was provided in the ultimate agreement. The lien was not waived by the preliminary negotiations.

> "It is apparent that one cannot impliedly waive a right before such right exists. . . . It was not until later when he transferred to the defendants the legal title without payment of the consideration, that the law created for him a lien."
>
> *Maltby v. Conklin,* 50 Cal. App. 201.

Conclusion.

In conclusion, Appellees Polikowsky respectfully submit that the conclusions of the District Court as drawn from the uncontroverted evidence should be sustained by this honorable court for the following reasons:

Their vendor's lien was not waived by the acceptance of security other than the personal obligation of the purchasers, as it would be abhorrent to equity to permit the Schmidts to claim that their dummy corporation should be considered a separate entity.

Their vendor's lien was not waived by agreeing to give a title to the effect that the public records would disclose no lien, a vendor's lien in its very essence being unrecorded.

The Appellees are not estopped from asserting the lien for the reason that no rights of innocent third parties are in any manner prejudiced.

And for the most basic reason that the very injustice of insisting that the property of these Appellees be subjected to the rights of general creditors who lent no credit nor even knew of this transfer is palpably unfair and inequitable.

Respectfully submitted,

JOHN K. BLANCHE,

Attorney for Appellees, Clarence E. and Winnifred Polikowsky.